COMMONWEALTH OF MASSACHUSETTS
DEPARTMENT OF PUBLIC UTILITIES

Petition of Massachusetts Electric Company for review of its electric industry restructuring proposal	D.P.U. 96-25

COMMENTS OF XENERGY, INC.

XENERGY, Inc. ("XENERGY") hereby submits written comments regarding the proposed settlement agreement submitted in the above-captioned proceeding by the Massachusetts Electric Company ("MECO"), the New England Power Company ("NEP") and Nantucket Electric Company, all companies of the New England Electric System ("NEES").

I. INTEREST OF XENERGY

XENERGY is a Massachusetts corporation headquartered in Burlington, Massachusetts. It has been in existence since 1975 and provides energy-related services to its clients. These include engineering and consulting services, construction management, energy audits, demand-side management and energy-efficiency services, energy software development, and energy metering and statistical analysis. In addition, XENERGY supplies gas and electricity supply management services to its clients, and therefore is a potential competitor to affiliates of MECO in a restructured industry. XENERGY was the supplier chosen by the Massachusetts High Technology Council ("MHTC") in connection with the MHTC/MECO pilot program for retail electric service to

certain MHTC members.

XENERGY is a wholly-owned subsidiary of NGE Enterprises, Inc., a wholly-owned subsidiary of the New York State Electric & Gas Corporation ("NYSEG"). NYSEG is a regulated investor-owned electric and natural gas utility in upstate New York.

Because of its activity in the marketplace for both natural gas and electricity, its relationship with a regulated utility, and its substantial experience with conservation and load-management programs, XENERGY is uniquely positioned to comment on issues raised by the proposed settlement agreement, including in particular the potential abuse of market power. In particular, issues have arisen during the MHTC pilot program which will have implications for the ongoing restructuring process and for the ultimate success of retail competition in Massachusetts and New England. This issues also bear on the provisions of the proposed MECO settlement.

II. ISSUES

A. Hoarding of Firm Transmission Capacity

1. Absent changes, New England will not benefit from out-of-region power.

XENERGY's experience during the MHTC/MECO pilot program has confirmed the existence of substantial barriers to the supply of inexpensive, environmentally sound, out-of-region power to the NEPOOL service area. The RFP to which XENERGY responded included Program Guidelines developed by MECO and NEP which defined the responsibilities of each of the parties in the pilot program:

MECO, MHTC, New England Power Company ("NEP"), and the Supplier. Specifically, the Supplier was responsible for delivery of power to the NEP system:

> Supplier shall be obligated to deliver the capacity and energy actually used by each account to a point or points on the New England Power Company transmission system ("Supplier Delivery Point"). Supplier shall be obligated to arrange for and pay all costs associated with delivery of its capacity and energy to the Supplier Delivery Point. "Choice: New England Massachusetts Pilot Program Proposed Guidelines," page 10.

Delivery of power from the Supplier Delivery Point to the MHTC customers was the responsibility of MECO, utilizing NEP's transmission system:

> MECO will:
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> bundle network transmission service and distribution service on behalf of each customer; ...
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> submit bills for Transmission, Distribution and Access portion of service. The Transmission Charges will cover Customer's allocation of the cost of transmission incurred by MECO, on NEP's transmission system from the Supplier Delivery Point... Id., pp. 2, 5.

In accordance with the Program Guidelines, XENERGY's original power supply plan, and the one on which it based its bid, was to bring in power from a low-cost generator in New York State, NYSEG, over a series of transmission lines owned by the New York Power Authority ("NYPA") and Niagara Mohawk Power Company ("NIMO") to a Supplier Delivery Point on the NEP system, specifically NEP's facilities at the New York-Massachusetts border between the Rotterdam substation and the Bear Swamp substation (a 230 KV tie between NEP and NIMO). XENERGY and NYSEG had negotiated a series of contracts for firm, all-

requirements capacity and energy from the NYSEG-owned Kintigh power station to be delivered under firm transmission agreements with NYPA and NIMO to this NEP point of delivery.

When XENERGY requested that NEP and MECO accept approximately 40 MW of power on a firm basis at its tie with NIMO for ultimate delivery to MHTC members, however, NEP and MECO agreed to provide only approximately 1 MW of firm transmission, with the remaining 39 MW of transmission provided only on an as-available, non-firm basis.

NEP and MECO asserted that capacity on the Rotterdam-Bear Swamp tie was constrained, but that they were nonetheless holding approximately 100 MW of their allocation on the tie for potential future "economy purchases." NEP and MECO did not, however, state the extent to which the interface was likely to be used for economy purchases, if at all. In addition, NEP and MECO refused to discuss pricing of a potential sale of firm transmission rights over the interface, despite the failure of MECO and NEP to justify the need to reserve that interface for transmission of economy purchases (it would appear that such costs would have been very low, in light of the fact the tie was seldom if ever used for economy purchases).

2. Adverse effects of transmission hoarding

As noted by the Federal Energy Regulatory Commission in Order 888, "it is in the economic self-interest of transmission monopolists, particularly those with high-cost generation assets, to deny transmission or to offer transmission on a basis that is

inferior to that which they provide themselves." Federal Register (May 10, 1996), at 21567. Among the examples of anti-competitive conduct which prefaced this statement were "refusal by a ... public utility to offer firm service" and a "common contracting practice among utilities restricting the use of interconnections to themselves." Id. FERC expressed concern that "a transmission customer may reserve certain capacity simply to prevent everyone else from using it and to make its own generation the only alternative available on the market." Id. at 21574.

Because XENERGY was refused firm transmission rights by NEP and MECO, it proved impossible to bring reliable and inexpensive out-of-region power into New England on a reliable basis. XENERGY was in fact informed by NEP management that NEP never anticipated an out-of-region supplier bidding for the MHTC load, let alone winning the bid.

If Massachusetts and New England are to benefit from competition to the fullest extent possible as a result of electric industry restructuring, it will be critical to ensure that rules for pricing and allocating firm transmission over various lines are clearly developed at the federal and state levels so as to foster a competitive marketplace and to preclude uneconomic and potentially anti-competitive practices. At the federal level, FERC has expressed the willingness to address allegations that "a transmission customer is withholding scarce capacity in a way that has an anticompetitive effect" under Section 206 of the Federal Power Act. Id. While the opportunity

for case-by-case adjudication may remedy some abuses, the process is likely to be cumbersome. The generic industry structure and rules with regard to transmission allocation and cost recovery should be designed in a way to preclude inefficient hoarding of transmission rights. Unfortunately, however, as set forth below, the MECO settlement proposal does not resolve the potential anticompetitive problems caused by transmission hoarding.

3. The potential for hoarding remains with the MECO settlement.

NEP should be commended for establishing the principle of voluntary divestiture of their generating assets to non-affiliated entities, with retention only of transmission facilities. If divestiture under the settlement were complete, total and absolute, and if NEP, MECO and their affiliates had no option to bundle transmission rights with power sales, there would perhaps be less concern about hoarding of transmission rights, since NEP and MECO would have no reason to favor one generator or marketer over another. The proposed MECO settlement, however, leaves open the opportunity for NEP and MECO affiliates to enter the business of generating and marketing electricity and other energy services. Although NEP agrees to sell, spin off or otherwise transfer ownership of its generating assets, NEP under the settlement agreement explicitly retains the opportunity to sell power in wholesale markets and to become an exempt wholesale generator. Settlement Agreement, p. 33 (Book 1, p. 52). Further, MECO affiliates can enter the generation business:

> Nothing in this Settlement shall prevent an affiliate of Mass. Electric from re-entering the generation business following the completion of divestiture, and nothing in this Settlement shall prevent affiliates of Mass. Electric from marketing electricity, other energy sources, or energy services to customers within or outside Mass. Electric's service territory. Settlement Agreement, p. 34 (Book 1, p. 53).

Thus, NEP, MECO and their affiliates remain potential players in competitive energy markets.

Further, the potential for NEPOOL restructuring does not preclude transmission hoarding. For example, while the current NEPOOL Restructuring Proposal, which is Attachment 11 to the Settlement Agreement, indicates that an independent system operator ("ISO") will be established, that Proposal also makes clear that NEP and other NEPOOL members will continue to control the rules under which the transmission system will be run. NEP will continue to own its transmission facilities, and will not even lease those facilities to the ISO. Attachment 11, p. 36 (Book 3, p. 133). Further, the ISO will set neither transmission rates nor tariffs; they will continue to be established by NEPOOL members, including owners of transmission such as NEP. See, e.g., Attachment 11, pp. 2, 31, 36 (Book 3, pp. 99, 128, 133). The ISO, although it would be "independent" and "neutral," would merely "implement the rules established by the NEPOOL Participants" and would "simply implement and enforce" tariffs filed by the transmission providers and the responsible NEPOOL committee. Attachment 11, pp. 6, 36 (Book 3, pp. 103, 133).

Moreover, insofar as it addresses the specific conditions which have created the potential for hoarding of transmission rights, NEES's NEPOOL Restructuring Proposal offers no

resolution. The Proposal states simply that "[p]riority rights for use of ties is a subject under discussion." Attachment 11, p. 74 (Book 3, p. 171).[1] Similarly, it is stated that the issue of congestion pricing "will be under discussion and it is not yet clear whether transmission congestion is best dealt with through transmission provision or through spot market." Attachment 11, p. 72 (Book 3, p. 169). Further, with respect to out-of-region suppliers, NEES's NEPOOL Restructuring Proposal states that each "Participant will bear the burden on regional installed capacity requirements of the contracts entered into with others outside the NEPOOL Control Area," but explicitly leaves the mechanism for this so-called "Outside Transaction Adjustment" "still to be developed." Attachment 11, p. 51 (Book 3, p. 148). This "Adjustment" could be defined so that any out-of-region power would be effectively excluded from the NEPOOL Control Area, just as "priority rights for use of ties" or the pricing for use of the ties could exclude out-of-region power to the benefit of

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[1]Indeed, the "Terms, Conditions and Settlement Process with Suppliers Under Retail Delivery Rates" which are Attachment 9 to the settlement state that "Supplier shall be obligated to deliver the capacity and energy actually used by each Account to a point or points on the NEP transmission system ("Supplier Delivery Point") where firm service is available" (emphasis supplied). This differs from the requirements of the MHTC/MECO pilot program, which did not include the underlined language, and makes clear a potential intent to restrict access to the NEP transmission system.

Attachment 9 also seeks independently to impose requirements on Suppliers attempting to serve MECO customers which may not ultimately be required by NEPOOL or be necessary to ensure system integrity. Attachment 9, for example, requires that any supplier be a member of NEPOOL and have an own-load dispatch established within the NEPOOL billing system or have an agreement whereby a NEPOOL member agrees to include the load in its own-load dispatch. Attachment 9, Sheet 2 (Book 3, p. 53).

producers inside NEPOOL and to the disadvantage of a competitive marketplace and consumers.

Transmission owners (such as NEP) and their affiliates (such as MECO and *All*Energy) should not be permitted to compete as marketers unless it is clear that they will not receive favorable "priority rights" or favorable pricing for the use of constrained transmission or distribution facilities. To the extent that regulated utilities are permitted to have marketing affiliates, transmission and distribution capacity rights must be made available on equal terms to all generators and power marketers rather than reserved for affiliates of the utility, in order to ensure that transmission and distribution facilities are actually put to its highest and best use. Prior to approving the settlement, the Department should ensure that the rules by which transmission and distribution rights will be allocated and priced are made clear.[2]

Anything other than an open market for transmission and distribution rights, particularly over constrained interfaces and in congested areas, will provide the opportunity for hoarding and lead to market distortions. This is particularly true if the rights are controlled by a generator with facilities close to the

[2]For example, do MECO and NEP intend to reserve rights for MECO for Standard Offer service, or will rights be equally available to all suppliers. Is there an intent to reserve particular delivery points on the NEP system or transmission routes to MECO or other affiliated companies? To the extent that certain issues are within FERC's jurisdiction, the Department should be prepared to condition approval of the settlement on appropriate resolution of those issues, to direct that procompetitive tariffs be filed with FERC, and to intervene to seek the approval of such tariffs.

load being served, since control of the rights can be used to exclude others from supplying the load.[3]

B. Code of Conduct.

The traditional position of the regulated monopoly utility will change with deregulation; indeed, that change has already begun. Regulated utilities now have competitive affiliates, such as Northfield Mountain Energy or NU Wholesale Power (affiliates of Northeast Utilities and Western Massachusetts Electric Company), or NEES Energy, Inc. (an affiliate of NEES, NEP and MECO). Indeed, formal affiliate relationships now cut across traditional lines, as evidence by the creation of *All*Energy Marketing Company, L.L.C., a combination of NEES Energy, Inc. and *All*Energy Marketing Company, Inc. (a subsidiary of Eastern Enterprises, the parent of Boston Gas Company) and the announcement of the affiliation between Boston Edison and Williams Energy Group, a gas marketer.

The local electric utility now has and will continue to have direct contact with retail customers in its role as monopoly provider of distribution service. That role gives the regulated utility unique access to customer information as well as unique

[3]Even absent restructuring, the Department should ensure that regulated electric utilities are not allowed to recover the cost of transmission capacity which they have reserved absent a demonstration that such capacity is in fact being used for transmission of economy purchases which actually benefit ratepayers. At present, there is no financial disincentive to hoarding; the allocated cost of capacity is borne by ratepayers regardless of whether that capacity is actually used to benefit those ratepayers. As a result, the highest and best use is not being made of constrained transmission facilities; they can remain unused while more efficient uses are precluded.

access to the customers themselves. The market power provided by such access can be abused by the regulated utility, to the benefit of its unregulated affiliates.

For example, XENERGY has been made aware of MHTC members and other customers being referred to *All*Energy by MECO with respect to potential supply arrangements, and joint marketing efforts by *All*Energy and MECO, rather than the customer being provided a listing of all qualified suppliers.[4] Employees of a regulated utility are used to enhance the efforts of unregulated affiliates. Abuse can also exist when customer information (including not only detailed customer information such as load data, but also the mere expression of interest by a customer in securing an alternative energy supply and other customer referrals) is transferred to an unregulated affiliate, but not also simultaneously made publicly available or available to competitors of the unregulated affiliate. MECO and its affiliates should not be allowed to leverage the monopoly position of a regulated utility, by utilizing established customer contacts and the ability to identify potential customers without the customer acquisition costs of other suppliers.

XENERGY's experience during the pilot has made clear that the Code of Conduct which is ultimately promulgated for both gas and electric utilities must unambiguously preclude abuse of market power by monopoly utilities. The "Compliance Procedures"

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[4]Such listing should not be in alphabetical order. While XENERGY would not object to a listing in reverse alphabetical order, it recommends that listings in random order be supplied to various customers.

proposed by MECO, as set forth in Attachment 14 to the settlement, are woefully inadequate. The Department has already promulgated a detailed Code of Conduct for utilities within its jurisdiction, in D.P.U. 96-44, the rulemaking docket applicable to gas LDCs. No less should be required for electric utilities, and the code outlined in D.P.U. 96-44 should supplement the code proposed by the Department for electric utilities on May 1, 1996 in D.P.U. 96-100.

For example,

- The "Compliance Procedures" should be applied to dealings not only with *All*Energy but also with any other affiliated power marketers. Further, because of the structure of the NEES companies, it is necessary to ensure that proper rules govern the conduct not only of MECO, which holds and will continue to hold a ratepayer-funded distribution monopoly, but also of NEP, which currently holds and will continue to hold a ratepayer-funded transmission monopoly, and which owns ratepayer-funded generating facilities.

- The "Compliance Procedures" now state that representatives of *All*Energy are not permitted "preferential access to any non-public information of Mass. Electric about the distribution system or customers that is not made available to unaffiliated nonregulated power producers upon request." The "upon request" limitation appears designed to provide an open door to preferential information sharing by MECO, and will certainly have that effect. Information could be shared only with *All*Energy or other affiliates, and nonaffiliated power marketers would have no knowledge of such sharing and therefore would be unable to make the necessary "request" for such information.

  The Department should impose requirements such as those set forth in its proposed Code of Conduct in D.P.U. 96-44, the rulemaking docket applicable to gas LDCs, and flatly prohibit the sharing of proprietary customer information and leads to marketing affiliates. Further, it should require that any information provided to a marketing affiliate be provided "simultaneously" to all generators and marketers whether they are "affiliated" or "nonaffiliated." Disclosure should be self-executing, and not depend on a "request." See also Southern Company Services, Inc., 72 FERC ¶ 61,324, at 62,409 & n.49 (1995); Heartland Energy Services, Inc., 68 FERC ¶ 61,223, at 62,063 (1994).

- The "Compliance Procedures" do not prohibit joint marketing efforts, or use of utility employees to enhance the marketing efforts of *All*Energy or any other marketing affiliates. As noted above, such efforts have already occurred and they can be expected to continue in the future unless restrained.

  Again, restrictions such as those set forth in the proposed Code of Conduct in D.P.U. 96-44 should be imposed. For example, that Code of Conduct provides that "LDCs ... shall refrain from giving any appearance that the LDC speaks on behalf of its affiliate." It further provides that "Employees of an LDC and Employees of its Marketing Affiliate shall not be shared, and shall be physically separated from each other."

- The difficulty faced by XENERGY is securing firm transmission provides another example of the potential for anticompetitive behavior, where such firm transmission is reserved for affiliated companies even if not actually used. The Department must ensure that industry restructuring takes place in an environment where rules at both the federal and state level preclude not only the discriminatory transfer of information, but also the discriminatory provision of other services by regulated public utilities, including without limitation discriminatory access to and pricing of distribution or transmission service, rights over constrained transmission or distribution lines, sales of capacity, energy or ancillary services by regulated generation companies, and so on.[5] If that is not the case, there could be a transfer of benefits from the affiliated public utility (and its captive ratepayers) to the unregulated affiliate (and its shareholders). See, e.g.,

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[5]An example is set forth in more detail in XENERGY's recent comments in D.P.U. 96-44 (September 27, 1996). Regulated electric utilities in New England with gas-fired generation plants have secured long-term gas service contracts which include firm gas transportation rights, ostensibly to serve generation needs. In dealing with various MHTC members with respect to the issue of gas service as well as electric service, XENERGY has learned that electric utilities in New England are selling gas service including firm transportation rights (which have great potential value in New England), both through unregulated marketing affiliates and to unaffiliated marketers. Such sales have been accomplished without any imposition of a market-based mechanism which would provide opportunities to competing marketers such as XENERGY or which would establish the highest and best price for such sales, and thereby allow the greatest flowback to electric ratepayers. Not only are electric ratepayers, who are responsible for the cost of gas supply contracts, forced to cross-subsidize gas marketing efforts, but also competition is precluded in the market for natural gas.

Heartland Energy Services, Inc., 68 FERC ¶ 61,223, at 62,062-63.

C. C&LM Marketing by Regulated Electric Utilities

XENERGY has, since its founding in 1975, provided demand-side management and energy-efficiency services to its clients. The MECO settlement proposal proposes a substantial level of C&LM and renewables expenditures at least through the year 2001. These expenditures will be funded by a broad-based charge on all utility ratepayers, whether or not they are recipients of the C&LM services.

XENERGY's experience has demonstrated that such expenditures, to the extent they are approved by the Department, should be carefully controlled.[6] This holds true both before and after restructuring, and regardless of whether divestiture has or has not occurred. First, it should be explicitly clear that C&LM expenditures are unconditional, without any existing or future service commitment to a supplier affiliated with the distribution utility. Second, there must be assurances that C&LM expenditures, which are no-cost or low-cost benefits to customers, are not used to build "brand loyalty" or goodwill for the affiliated marketing company. This requires, at a minimum, that a strict code of conduct apply to customer contacts in

[6]The Department must seriously consider the economic justification for the level of expenditures set forth in the Settlement Agreement, and in particular for development of fuel cells and clean renewables, an investment which rises to approximately $20 million in the year 2001, or about one-third of the entire C&LM budget. XENERGY assumes that the Department will continue some level of funding for C&LM services, and the remainder of its comments on that issue seek to ensure that such funds are not utilized in an anticompetitive manner.

connection with C&LM services, or, better, that such contacts be administered by an independent entity as is the case in Vermont.

Third, competitive opportunities in the markets which are being subsidized by ratepayer funds must be maximized, both to ensure opportunities for all competing suppliers of C&LM services and renewable energy and to ensure the most efficient use of funds. At least for larger commercial and industrial customers, when a C&LM service is determined to be cost-justified and therefore eligible for ratepayer subsidization, all qualified C&LM providers should have an opportunity to provide the service, in a non-discriminatory fashion. The customer should have the opportunity to choose its supplier, and the regulated utility should not direct the customer to one provider. For smaller customers receiving services under standardized programs, competitive bidding should be utilized.

Ensuring equal access to the C&LM market is particularly important to providers such as XENERGY, which not only provides C&LM services but also competes with the unregulated marketing affiliates of utilities. Utilities should not have the opportunity to direct business away from their competitors and toward more "benign" or "compliant" C&LM providers who do not compete to supply gas or electricity to users. In addition, utilities should not have the opportunity to direct customers to their affiliates who may be providing C&LM services.[7] The

[7]As noted above, MECO has reserved the right under the Settlement Agreement to have affiliates offer not only energy but also "energy services" to "customers within or outside Mass. Electric's service territory." Settlement Agreement, p. 34 (Book 1, p. 53).

Department must carefully monitor the use of C&LM monies, which are ratepayer funded, to ensure that they are not used to enhance market power of the utility and its affiliates, or to reward or punish competitors. The Settlement Agreement states that "[o]ptimal use should be made of competitive bidding in funding commercialization activities." Settlement Agreement, p. 25 (Book 1, p. 44). That same principle of competition should apply to all C&LM and renewables programs.

D. Department Enforcement Authority

The unprecedented restructuring of electric and gas markets in Massachusetts, and the likelihood that market vitality and competitiveness will depend on compliance with codes of conduct, requires that effective enforcement authority be available. Thus, as part of any electric industry restructuring package submitted to the Great and General Court, the Department should include adequate enforcement authority, including the right to enjoin misconduct and the right to award damages to entities which are harmed by anticompetitive utility behavior.

III. CONCLUSION

Approval of the settlement agreement proposed by MECO, NEP and the NEES

companies should be conditioned on assurances that anticompetitive behavior will be precluded, as set forth above.

Respectfully submitted,

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Richard W. Benka, BBO #037320
Foley, Hoag & Eliot LLP
One Post Office Square
Boston, MA 02109
(617) 832-1000

Dated: October 29, 1996

CERTIFICATE OF SERVICE

I hereby certify that I have this day caused the foregoing document to be served upon all parties of record in this proceeding in accordance with the requirements of 220 C.M.R. 1.05(1) (Department Rules of Practice and Procedure).

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Richard W. Benka
Counsel for XENERGY, Inc.

Dated: October 29, 1996